

The OTS is posting this draft version of the interagency joint proposed rule revising the capital rules for the treatment of residual interests in asset securitizations or other transfers of financial assets. When the final version of the proposed rule is published in the *Federal Register*, the OTS will include a link to that version on this site.

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 3

[Docket No.]

RIN 1559–AB14

FEDERAL RESERVE BOARD

12 CFR Parts 208 and 225

[Regulations H and Y; Docket No.]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 325

RIN

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Part 565 and 567

[Docket No.]

RIN 1550-AB11

Capital; Leverage and Risk-Based Capital Guidelines; Capital Adequacy

Guidelines; Capital Maintenance: Residual Interests in Asset Securitizations or

Other Transfers of Financial Assets

ACTION: Notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS) (collectively, the Agencies) propose to amend their capital adequacy standards for banks, bank holding companies and thrifts (collectively, banking organizations) concerning the treatment of certain residual interests in asset securitizations or other transfers of financial assets.

Residual interests are defined as those on-balance sheet assets that (a) represent interests (including beneficial interests) in the transferred financial assets retained by a seller (or transferor) after a securitization or other transfer of financial assets; and (b) are structured to absorb more than a pro-rata share of credit loss related to the transferred assets through subordination provisions or other credit enhancement techniques (i.e., credit enhancement). Examples of residual interests include, but are not limited to, interest only strips receivable (I/O strips), spread accounts, cash collateral accounts, retained subordinated interests, and other similar forms of on-balance sheet assets that function as a credit enhancement. Residual interests as defined in the proposed rule do not include interests purchased from a third party.

Generally, these residual interests are non-investment grade or unrated assets retained by the issuing institution in order to provide "first-loss" credit support for the senior positions in a securitization or other financial asset transfer. They generally lack an active market through which a readily available market price can be obtained. In addition, many of these residual interests are exposed, on a leveraged basis, to a significant level of credit and interest rate risk that make their valuation extremely sensitive to changes in the underlying credit and prepayment assumptions. As a result, such residual interests present valuation and liquidity concerns. High concentrations of such illiquid and volatile assets in relation to capital can threaten the safety and soundness of banking organizations.

This proposed rule is intended to better align regulatory capital requirements with the risk exposure of these types of residual interests, encourage conservative valuation methods, and restrict excessive concentrations in these assets. The proposed rule would require that risk-based capital be held in an amount equal to the amount of the residual interest that is retained on the balance sheet by a banking organization in a securitization or other transfer of financial assets, even if the capital charge exceeds the full risk-based capital charge typically held against the transferred assets. The proposed rule also would restrict excessive concentrations in residual interests by limiting the amount that may be included in Tier 1 capital for both leverage and risk-based capital purposes. When aggregated with nonmortgage servicing assets and purchased credit card relationships (PCCRs), the balance sheet amount of residual interests would be limited to 25 percent of Tier 1 capital, with any amount in excess of this limitation deducted in determining the amount of a banking organization's Tier 1 capital.

DATES: Comments must be received by [INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: Comments should be directed to:

OCC: Comments may be submitted to Docket No. 00- , Communications Division, Third Floor, Office of the Comptroller of the Currency, 250 E Street, S.W., Washington, DC 20219. Comments will be available for inspection and photocopying at

that address. In addition, comments may be sent by facsimile transmission to FAX number (202/874-5274), or by electronic mail to regs.comment@occ.treas.gov.

Board: Comments directed to the Board should refer to Docket No. [] and may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington DC 20551. Comments addressed to the attention of Ms. Johnson may also be delivered to Room B-2222 of the Eccles Building between 8:45 a.m. and 5:15 p.m. weekdays, or the security control room in the Eccles Building courtyard on 20th Street, N.W. (between Constitution Avenue and C Street) at any time. Comments may be inspected in Room MP-500 of the Martin Building between 9:00 a.m. and 5:00 p.m. weekdays, except as provided in 12 CFR 261.8 of the Board's Rules Regarding Availability of Information.

FDIC: Send written comments to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429. Comments may be hand-delivered to the guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. Send facsimile transmissions to FAX number (202/898-3838); Internet address: comments@fdic.gov.) Comments may be inspected and photocopied in the FDIC Public Information Center, Room 100, 801 17th Street, N.W., Washington, DC 20429, between 9:00 a.m. and 4:30 p.m. on business days.

OTS: Send comments to Manager, Dissemination Branch, Information Management and Services Division, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention Docket No. 2000- _____. Hand deliver comments to the Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9:00 a.m. to 4:00 p.m. on business days. Send facsimile transmissions to FAX Number (202) 906-7755; or (202) 906-6956 (if comments are over 25 pages). Send e-mails to public.info@ots.treas.gov, and include your name and telephone number. Interested persons may inspect comments at the Public Reference Room, 1700 G Street, N.W., from 10:00 a.m. until 4:00 p.m. on Tuesdays and Thursdays.

FOR FURTHER INFORMATION CONTACT:

OCC: Amrit Sekhon, Risk Specialist (202/874-5211), Capital Policy; Ron Shimabukuro, Senior Attorney or Laura Goldman, Senior Attorney, Legislative and Regulatory Activities Division (202/874-5090).

Board: Thomas R. Boemio, Senior Supervisory Financial Analyst (202/452-2982); Arleen Lustig, Supervisory Financial Analyst (202/452-2987), Division of Banking Supervision and Regulation; and Mark E. Van Der Weide, Counsel, (202/452-2263), Legal Division. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), Diane Jenkins (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, DC 20551.

FDIC: William A. Stark, Assistant Director, Division of Supervision (202/898-6972); Stephen G. Pfeifer, Senior Examination Specialist, Division of Supervision (202/898-8904); Keith A. Ligon, Chief, Policy Unit, Division of Supervision (202/898-3618); and Marc J. Goldstrom, Counsel, Legal Division (202/898-8807).

OTS: Michael D. Solomon, Senior Program Manager for Capital Policy (202/906-5654), and Teresa A. Scott, Counsel, Banking and Finance (202/906-6478), Regulation and Legislation Division, Office of the Chief Counsel, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552.

SUPPLEMENTARY INFORMATION: This preamble consists of the following sections:

- I. Introduction
- II. Nature of Supervisory Concerns
- III. Current Capital Treatment for Residual Interests
- IV. Residual Interests Subject to the Proposal
- V. Proposed Amendments to the Capital Standards
- VI. Request for Public Comment
- VII. Plain Language
- VIII. Regulatory Analysis

I. Introduction

The proposed rule addresses the supervisory concerns arising from the illiquid and volatile nature of residual interests that are retained by the securitizer or other seller of financial assets, when those residual interests are used as a credit enhancement to support the financial assets transferred. The proposal also reduces the risk from excessive concentrations in these residual interests, including those situations where large residual interests are retained in connection with the sale or securitization of low quality, higher risk loans. As discussed in more detail in Section V, the proposed rule would (1) require capital to be maintained in an amount equal to the amount of the residual interest that is retained on the balance sheet for risk-based capital purposes, and (2) require the amount of any such residual interests to be included in the 25 percent of Tier 1 capital sublimit that currently applies to nonmortgage servicing assets and purchased credit card relationships (PCCRs), with any amounts in excess of this limit deducted from Tier 1 capital for both leverage and risk-based capital purposes.

II. Nature of Supervisory Concerns

Securitizations and other financial asset transfers provide an efficient mechanism for banking organizations to securitize and sell loan assets or credit exposures. The benefits of these transactions must be balanced against the significant risks that such activities can pose to banking organizations and to the deposit insurance funds. Recent examinations have disclosed significant weaknesses in the risk management processes related to securitization activities at certain institutions. The most frequently encountered problems stem from: (1) the failure to recognize recourse obligations that frequently

accompany securitizations and to hold sufficient capital against such obligations; (2) the excessive or inadequately supported valuation of residual interests; (3) the liquidity risk associated with over reliance on asset securitization as a funding source; and (4) the absence of adequate independent risk management and audit functions.

The Agencies addressed these concerns in the *Interagency Guidance on Asset Securitization* (Securitization Guidance) issued in December 1999.¹ The Securitization Guidance highlighted some of the risks associated with asset securitization and emphasized the Agencies' concerns with certain residual interests generated from the securitization and sale of assets.

The Securitization Guidance addressed the fundamental risk management practices that should be in place at institutions that engage in securitization activities and stressed the need for bank management to implement policies and procedures that include limits on the amount of residual interests that may be carried as a percentage of capital. In particular, the Securitization Guidance sets forth the supervisory expectation that the value of a residual interest in a securitization must be supported by objectively verifiable documentation of the asset's fair market value utilizing reasonable, conservative valuation assumptions. Under this guidance, residual interests that do not meet this expectation, or that fail to meet the supervisory standards set forth in the Securitization Guidance, should

¹ See OCC Bulletin 99-46 (December 14, 1999)(OCC); FDIC FIL 109-99 (December 13, 1999)(FDIC); SR 99-37(SUP)(December 13, 1999)(FRB); and CEO LTR 99-119 (December 14, 1999) (OTS). See this guidance for a more detailed discussion of the risk management processes applicable to securitization activities.

be classified as "loss" and disallowed as assets of the banking organization for regulatory capital purposes.

Moreover, the Agencies indicated in this guidance that institutions found lacking effective risk management programs or engaging in practices that present safety and soundness concerns would be subject to more frequent supervisory review, limitations on residual interest holdings, more stringent capital requirements or other supervisory response. The Securitization Guidance further advised the industry that given the risks presented by securitization activities, and the illiquidity and potential volatility of residual interests, the Agencies were actively considering the establishment of regulatory restrictions that would limit or eliminate the amount of certain residual interests that may be recognized in determining the adequacy of regulatory capital.

The Agencies have identified three areas of continuing supervisory concern:

- (1) inappropriate or aggressive valuations of residual interests;
- (2) inadequate capital in relation to the risk exposure of the organization retaining residual interests; and,
- (3) excessive concentrations of residual interests in relation to capital.

The Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities" (FAS 125)² governs the recognition of a residual interest in a securitization as an asset of the

² FAS 125 establishes certain transfer of control, accounting, and valuation criteria surrounding the transfer of financial assets as a benchmark for determining whether a transfer is recorded as a "sale"

sponsoring institution. Under these generally accepted accounting principles (GAAP), when a transfer of assets is treated as a sale, the securitizing or selling institution carries residual interests as assets on its books at an estimate of fair value.³ Retaining this residual interest on the balance sheet in connection with a sale generally has the effect of increasing the amount of current earnings generated by the gains from the sale.

The Agencies have become increasingly concerned with fair value estimates that are based on unwarranted assumptions of expected cash flows. No active market exists for many residual interests. As a result, there is no marketplace from which an arm's length market price can readily be obtained to support the residual interest valuation. Recent examinations have highlighted the inherent uncertainty and volatility regarding the initial and ongoing valuation of residual interests. A banking organization that securitizes assets may overvalue its residual interests and thereby inappropriately generate "paper profits" (or mask actual losses) through incorrect cash flow modeling, flawed loss assumptions, inaccurate prepayment estimates, and inappropriate discount rates. Residual interests are exposed to a significant level of credit and interest rate risk that make their valuation extremely sensitive to changes in the underlying assumptions. Market events can affect the discount rate or performance of assets supporting residual interests and can swiftly and dramatically alter their value. Should the institution hold an

and, if so, at what value it is recorded. Under FAS 125, the transferring financial institution generally will immediately recognize gains from the sale of the transferred assets and record retained interests in a manner that captures all of the financial components, including the residual interests that arise in connection with the securitization or other asset transfer.

³ The fair value reflects the expected future cash flows discounted at an appropriate market interest rate, and is calculated using assumptions regarding estimated credit loss rates and prepayment speeds.

excessive concentration of such assets in relation to capital, the safety and soundness of the institution may be threatened.

The Agencies believe that the current regulatory capital requirements do not adequately reflect the risk of unexpected losses associated with these transactions. The booking of a residual interest using gain-on-sale accounting can increase the selling institution's capital and thereby allow the bank to leverage the capital created from the securitization. This increased leverage resulting from the current recognition of uncertain future cash flows is a supervisory concern. Accordingly, the proposed rule focuses on those transfers of financial assets treated as sales under GAAP.⁴

A related concern is the adequacy of capital held by institutions that securitize or sell assets and retain residual interests. First, the lack of liquidity of residual interests and the potential volatility of these residual interests arising from their leveraged credit and interest rate risk limits their true ability to support the institution, especially in times of stress. Second, any weaknesses in the valuation of the residual interest can translate into weaknesses in the quality of capital available to support the institution. Liberal or unsubstantiated assumptions can result in material inaccuracies in financial statements. Even when such residual interests have been appropriately valued, relatively small

⁴ When the securitization or other transfer of financial assets is treated as a financing, under GAAP and for regulatory capital purposes, rather than a sale, the assets continue to be reflected on the balance sheet of the transferring institution. In these circumstances, the assets continue to be subject to the minimum capital requirement (generally 8%). The level of supervisory concern is diminished through this treatment because there is no residual interest created to pose valuation or liquidity concerns. Importantly, under a financing transaction there are no earnings leading to the creation of capital. For this reason the proposal addresses only amendments to the regulatory capital requirements for banking organizations when they securitize or otherwise transfer financial assets and treat them as sales under GAAP.

changes in the underlying assumptions can lead to material changes in the residual interest's fair value. Inaccuracies in the initial valuation of residual interests, as well as changes in the underlying assumptions over time, can result in substantial write-downs of residual interests. If these generally illiquid and volatile residual interests represent an excessive concentration of the institution's capital, they can contribute to the ultimate failure of the sponsoring institution.

The concerns regarding excessive concentration and adequacy of capital are heightened where the residual interests are generated from the securitization of certain assets, such as low-quality or high loan-to-value loans. Recent examinations have shown that in order to provide adequate credit enhancement to the senior positions in securitizations involving low quality assets, institutions generally must retain relatively greater credit risk exposure. In such transactions, the sponsoring institutions may retain residual interests in amounts that exceed the risk-based capital that would have been associated with the loans had they not been transferred.

Because of these continuing supervisory concerns, the Agencies believe it is appropriate to propose these revisions to their respective capital adequacy rules in order to limit the amount of residual interests that are retained by banking organizations and require adequate capital for the risk exposure created.

III. Current Capital Treatment for Residual Interests

A. Assets Sold "With Recourse"⁵

Under current risk-based capital guidelines, banking organizations that retain "recourse" on assets sold generally are required to hold capital as though the loans remained on the institution's books,⁶ up to the "full capital charge."⁷ For regulatory capital purposes, recourse is generally defined as an arrangement in which a banking organization retains the risk of credit loss in connection with an asset transfer, if the risk of credit loss exceeds a pro rata share of the institution's claim on the assets.⁸

As required by statute,⁹ the Agencies have adopted rules that provide "low-level recourse" treatment for those institutions that securitize or sell assets and retain recourse

⁵ Consolidated Reports of Condition and Income (Call Report) instructions issued by the Federal Financial Institutions Examination Council provide examples of transfers of assets that involve recourse arrangements. See the Call Report Glossary entry for "Sales of Assets for Risk-Based Capital Purposes." These examples address the risk of loss retained in connection with transfers of assets. OTS currently defines the term "recourse" more broadly in its capital rules at 12 CFR 567.1 to include the "acceptance, assumption or retention" of the risk of loss. The Agencies have issued a separate proposal that, among other things, would provide a uniform definition of "recourse." See 65 Fed. Reg. 12319 (March 8, 2000).

⁶ Under the Agencies' current capital rules, assets transferred with recourse in a transaction that is reported as a sale under generally accepted accounting principles (GAAP) are removed from the balance sheet and are treated as off-balance sheet exposures for risk-based capital purposes. For transactions reported as a sale, the entire amount of the assets sold (not just the contractual amount of the recourse obligation) is normally converted into an on-balance sheet credit equivalent amount using a 100 percent conversion factor. This credit equivalent amount is then risk weighted for risk-based capital calculation purposes.

⁷ For assets that are assigned to the 100 percent risk-weight category, the full capital charge is 8 percent of the amount of assets transferred, and institutions are required to hold 8 cents of capital for every dollar of assets transferred with recourse. For assets that are assigned to the 50 percent risk-weight category, the full capital charge is 4 cents of capital for every dollar of assets transferred with recourse.

⁸ The risk-based capital treatment for sales with recourse can be found at 12 CFR Part 3 Appendix A, Section (3)(b)(1)(iii) (OCC); 12 CFR Part 208, Appendix A, Section III.D.1 and 12 CFR Part 225, Appendix A, Section III.D.1 (FRB); 12 CFR Part 325, Appendix A, Section II.D.1 (FDIC); and 12 CFR 567.6(a)(2)(i)(C) (OTS).

⁹ Low-level recourse treatment is mandated by section 350 of the Riegle Community Development and Regulatory Improvement Act, 12 USC 4808, which generally provides that: "the amount of risk-based capital required to be maintained...by any insured depository institution with respect to assets transferred with recourse by such institution may not exceed the maximum amount of recourse for which such institution is contractually liable under the recourse agreement."

in dollar amounts less than the full capital charge.¹⁰ Before the issuance of the low-level recourse rules, these institutions could have been required to hold a greater level of capital than their maximum contractual exposure to loss on the transferred assets. The low-level recourse treatment applies to transactions accounted for as sales under FAS 125 in which a banking organization contractually limits its recourse exposure to less than the full capital charge for the assets transferred.

Under the low-level recourse rule, a banking organization generally holds capital on a dollar-for-dollar basis up to the amount of the maximum contractual exposure. In the absence of any other recourse provisions, the on-balance sheet amount of the residual interests represents the maximum contractual exposure. For example, assume that a banking organization securitizes \$100 million of credit card loans and records a residual interest on the balance sheet of \$5 million that serves as a credit enhancement for the assets transferred. Before the low-level recourse rule was issued, the institution would be required to hold \$8 million of risk-based capital against the \$100 million in loans sold, as though the loans had not been sold. Under the low-level recourse rule, the institution would be required to hold \$5 million in capital, that is, "dollar-for-dollar" capital up to the institution's maximum exposure. In this low-level recourse example, the institution holds dollar-for-dollar capital against its maximum contractual exposure.

¹⁰ The Agencies' low-level recourse rules appear at: 12 CFR 3, Appendix A, Section 3(d) (OCC); 12 CFR 208, Appendix A, Section III.D.1.g and 225 Appendix A, Section III.D.1.g (FRB); 12 CFR 325, Appendix A, Section II.D.1 (FDIC); and 12 CFR 567.6(a)(2)(i)(C) (OTS). A brief explanation is also contained in the instructions for regulatory reporting in section RC-R for the Call Report or schedule CCR for the Thrift Financial Report.

Existing regulatory capital rules, however, do not require institutions to hold "dollar-for-dollar" capital against residual interests that *exceed* the full capital charge (\$8 million in the above example). Typically, institutions that securitize and sell higher risk assets are required to retain a large residual interest (often greater than the full capital charge of 8 percent on 100 percent risk-weighted assets) in order to ensure that the more senior positions in the securitization or other asset sale can receive the desired investment ratings. Write-downs of the recorded value of the residual interest, due to unrealistic (or changing) loss or prepayment assumptions, can result in residual losses that exceed the amount of capital held against these assets, thereby impairing the safety and soundness of the institution.

For example, assume that a banking organization securitizes \$100 million of subprime credit card loans and records a residual interest on the balance sheet of \$15 million that serves as a credit enhancement for the securitization. Under the current risk-based capital rules, the transferred loans would be treated as sold with recourse, and an 8 percent risk-based capital charge for these 100 percent risk-weighted loans would be required; that is, \$8 million in risk-based capital would be required to be held against the \$100 million of transferred loans. In this hypothetical example, however, the amount of residual interests retained on the balance sheet (\$15 million) exceeds the full equivalent risk-based capital charge held against the assets transferred (\$8 million). Accordingly, the amount of the residual interest is not fully covered by dollar-for-dollar risk-based capital; only \$8 million in capital is required to be held by the institution against the \$15 million residual interest exposure.

This example demonstrates that, for residual interests that exceed the dollar amount of the full capital charge on the assets transferred, current capital standards do not require dollar-for-dollar capital protection for the full contractual exposure to loss retained by the selling institution. Any losses in excess of the full capital charge (8 percent in the example above) could negatively affect the capital adequacy of the institution. Should the asset be written down from \$15 million to \$5 million, the \$8 million of required capital would be insufficient to absorb the full loss of \$10 million.

B. Prior Consideration of Concentration Limits on Residual Interests

In 1998, the Agencies amended their capital rules to change the regulatory capital treatment of servicing assets.¹¹ This rulemaking increased from 50 percent to 100 percent the amount of mortgage servicing assets that could be included in Tier 1 capital. The Agencies imposed more restrictive limits on the amount of nonmortgage servicing assets and PCCRs that could be included in Tier 1 capital. These stricter limitations were imposed due to the lack of depth and maturity of the marketplace for such assets, and related concerns about their valuation, liquidity and volatility.

At the time the Agencies issued the final rule on servicing assets, the Agencies declined to adopt similar capital limits for I/O strips, a form of residual interest, notwithstanding that certain I/O strips possessed cash flow characteristics similar to

¹¹ See 63 FR 42668 (August 10, 1998).

servicing assets and presented similar valuation, liquidity and volatility concerns. At that time, the Agencies chose not to impose such limitations in recognition of the "prudential effects of banking organizations relying on their own risk assessment and valuation tools, particularly their interest rate risk, market risk, and other analytical models."¹² The Agencies expressly indicated that they would continue to review banking organizations' valuation of I/O strips and the concentrations of these assets relative to capital. Moreover, the Agencies noted that they "may, on a case-by-case basis, require banking organizations that the Agencies determine have high concentrations of these assets relative to their capital, or are otherwise at risk from these assets, to hold additional capital commensurate with their risk exposures."¹³ In addition, most of the residual interests at that time that were used as credit enhancements did not exceed the full capital charge on the transferred assets and thus were subject to "dollar-for-dollar" capital requirements under the Agencies' existing low level recourse rules. However, a trend toward the securitization of higher risk loans has now resulted in residual interests that exceed the full capital charge and for which "dollar-for-dollar" capital is not required under the current risk-based capital rules. This trend has also resulted in certain organizations engaged in such securitization transactions having large concentrations in residual interests as a percentage of capital.

IV. Residual Interests Subject to the Proposal

¹² Id. at 42672.

¹³ Id.

Included in this proposal are residual interests that are structured to absorb more than a pro-rata share of credit loss related to the securitized or sold assets through subordination provisions or other credit enhancement techniques. Such residual interests can take many forms. Generally, these residual interests are non-investment grade or unrated "first-loss" positions that provide credit support for the senior positions of the securitization or other asset sale. A key aspect of such residual interests is that they reflect an arrangement in which the institution retains *risk of credit loss* in connection with an asset transfer. In addition to recourse provisions that may require the selling institution to support a securitization, residual interests can take the form of spread accounts, over-collateralization, subordinated securities, cash collateral accounts, or other similar forms of on-balance sheet assets that function as a credit enhancement. Servicing assets that function as credit enhancements would be subject to the proposed rule.

The definition of residual interests excludes those interests that do not serve as credit enhancements. In this regard, highly rated, liquid, marketable residual interests where the institution assumes only the interest rate risk associated with the assets transferred in the securitization (e.g., Fannie Mae or Freddie Mac interest-only strips) do not serve as a credit enhancement for the transferred assets and thus do not expose the institution to a concentrated level of credit risk. Further, such instruments are traded in a currently active marketplace and thus do not present the same degree of liquidity and valuation concerns.

The residual interests covered by the proposed rule are generally retained by the securitizing institution rather than sold because they are generally illiquid and volatile in nature and thus present liquidity and valuation concerns. Accordingly, the proposed rule extends only to residual interests that have been retained by a banking organization as a result of a securitization or other sale transaction where the residual interests serve as credit enhancements for the transferred assets.¹⁴

There may be instances, however, where such residual interests have been transferred or sold. Purchased residual interests can present the same degree of concentrated credit risk associated with retained residual interests. The exclusion of purchased residual interests from the proposed rule could establish a different capital treatment for the same asset, depending on whether the interest is purchased from a third party or retained in connection with the transfer of financial assets to a third party. The Agencies are particularly concerned about the possible "swapping" of residual interests, where there is otherwise limited breadth and depth of the market for these residual interests, and both parties stand to gain from, essentially, private valuations of each asset.

However, residual interests purchased in an arm's length transaction may not pose the same degree of liquidity risk as interests that are retained. In addition, purchased interests do not present the same opportunity to create capital as do interests that are originated and retained by a securitizing institution. Further, unlike retained residual interests where an overvaluation of the residual interest can lead to a higher gain on sale

¹⁴ The proposed rule would extend to all residual interests as defined, whether included in the banking book or included in the trading book and subject to the market risk rules.

and the creation of additional capital, there is a marketplace discipline on the initial amount at which a purchased residual interest is recorded (that is, it is limited to the purchase price), and there is no incentive on the part of the purchaser to pay a price above market because such a purchase does not create any capital for the purchaser.

The Agencies are considering including such purchased interests within the scope of the rule and are requesting comment on this issue.

V. Proposed Amendments to the Capital Standards

A. Proposed Treatment of Residual Interests

The Agencies propose to amend the regulatory risk-based capital standards by eliminating the distinction in treatment between low-level recourse obligations and the treatment of assets securitized or sold with recourse in those cases where the amount of the residual interest retained on balance sheet exceeds the full capital charge for the assets transferred. The current rules essentially place a ceiling on the "dollar-for-dollar" capital requirement for recourse obligations. Removal of this "cap" will ensure that all residual interests are subject to the same "dollar-for-dollar" capital standard that is applied to residual interests in low-level recourse transactions and that capital is held for the organization's total contractual exposure to loss.

In addition to modifying the risk-based capital treatment for residual interests, the Agencies propose limiting the amount of residual interests that can be recognized in determining Tier 1 capital under the Agencies' leverage and risk-based capital standards. The purpose of the limit is to prevent excessive concentrations in holdings of residual interests. The Agencies propose including residual interests within the 25 percent of Tier 1 capital sublimit already placed upon nonmortgage servicing assets and PCCRs. Under this restriction, any amounts of residual interests, when aggregated with nonmortgage servicing assets and PCCRs, in excess of 25 percent of Tier 1 capital, , would be deducted from Tier 1 capital for purposes of calculating both the risk-based and leverage capital ratios.¹⁵

In addition to including residual interests in the sublimit currently applied to PCCRs and nonmortgage servicing assets, residual interests would also be included in the calculation of the overall 100 percent limit on servicing assets. Under this proposal, the maximum allowable amount of mortgage servicing assets, PCCRs, nonmortgage servicing assets, and residual interests, in the aggregate, would be limited to 100 percent of the amount of Tier 1 capital that exists before the deduction of any disallowed mortgage servicing assets, any disallowed PCCRs, any disallowed nonmortgage servicing assets, any disallowed residual interests, and any disallowed deferred tax assets. The residual interests, however, would not be subject to the 90 percent of fair value limitation that applies to servicing assets and PCCRs. Under the proposed rule, residual interests would already be subject to a "dollar-for-dollar" capital requirement. Any residual

¹⁵ The unrealized gains that may be recorded by an institution with respect to residual interests that are accounted for as available-for-sale securities are presently not included in Tier 1 capital and would not be subjected to further deduction under this rule.

interests deducted in determining the Tier 1 capital numerator for the leverage and risk-based capital ratios also would be excluded from the denominators of these ratios.

In summary, under the proposed rule, institutions generally would be required to hold "dollar-for-dollar" capital for residual interests and additionally would be required to deduct from Tier 1 capital the amount of any residual interests (when aggregated with nonmortgage servicing assets and purchased credit card receivables) that exceed the established 25 percent sublimit. In combination, the proposal is intended to ensure that all residual interests are supported by "dollar-for-dollar" capital and that excessive concentrations (over 25 percent) in residual interests relative to capital are avoided.¹⁶

B. Net-of-Tax Treatment

The Agencies propose to extend the current net-of-tax treatment permitted in their existing capital standards to residual interests.¹⁷ Thus, the proposed rule would permit: (1) disallowed amounts of residual interests (that is, those amounts in excess of the 25 percent of Tier 1 capital sublimit) to be determined on a basis that is net of any associated deferred tax liability, and (2) any amounts of residual interests that are subject to the "dollar-for-dollar" capital requirement (that is, those amounts included in the 25 percent of Tier 1 capital sublimit) to be determined on a basis that is net of any associated

¹⁶ In connection with this proposal, the FDIC is also amending its regulations to remove an obsolete provision concerning the transitional 7.25% risk-based capital standard that was only effective until December 31, 1992. This provision currently appears in section III.B of Appendix A to Part 325. Similarly, OTS is making technical revisions to related regulatory provisions at 12 CFR 565.2(f).

¹⁷ The proposed treatment is consistent with that permitted for low-level recourse exposures, disallowed servicing assets, and disallowed intangible assets in non-taxable business combinations.

deferred tax liability. In instances where there is no difference between the book basis and the tax basis of the residual interest, no deferred tax liability would be created. Any deferred tax liability used to reduce the capital requirement for a residual interest would not be available for the organization to use in determining the amount of net deferred tax assets that may be included in the calculation of Tier 1 capital.¹⁸

The following example helps illustrate the proposed tax treatment. Assume residual interests of \$100 with an associated deferred tax liability of \$35 and Tier 1 capital (before the deduction of any disallowed residual interests) of \$200. In this example, the 25 percent concentration limit on residual interests (when combined with nonmortgage servicing assets and PCCRs) would be \$50 (i.e., 25 percent times \$200). The amount of disallowed residual interests (before considering the associated deferred tax liability) would have been \$50. The deferred tax liability associated with the otherwise disallowed residual interests of \$50 would be \$17.50 (a \$35 associated deferred tax liability against \$100 in residual interests drives a 35% tax effect against the \$50 disallowed residual interest). Thus, the amount of disallowed residual interests to be deducted in determining Tier 1 capital under the leverage and risk-based capital standards net of the associated deferred tax liability would be \$32.50 (i.e., the \$50 in disallowed residual interests minus the \$17.50 tax effect associated with the disallowed residual interests).

¹⁸ For example, see section 325.5(g) of the FDIC's capital regulations (12 CFR 325.5(g)), which sets forth the limitations on the amount of deferred tax assets that state nonmember banks can recognize for purposes of calculating Tier 1 capital under the leverage and risk-based capital rules.

In determining risk-weighted assets, the remaining \$50 amount of residual interests allowable in Tier 1 would be subject to a "dollar-for-dollar" capital on a basis that is also net of the deferred tax liability associated with the \$50 residual interest. The deferred tax liability associated with the \$50 not deducted from Tier 1 capital would be \$17.50 (i.e., the 35 percent tax effect as calculated above times \$50). Thus, the amount of residual interests that would be subjected to "dollar-for-dollar" treatment would be \$32.50 (\$50 less the \$17.50 in deferred tax liabilities). Calculation of this "dollar-for-dollar" capital charge is consistent with the "dollar-for-dollar" capital requirements that are currently required for low-level recourse transactions.

Other alternative calculations are possible and will be considered by the Agencies.¹⁹ The Agencies seek comment on whether the complexity of a "net-of-tax" approach is necessary and justified, and if so, what, if any, alternative calculations should be allowed.

C. Reservation of Authority

¹⁹ Two additional treatments are possible. Under the first approach, the amount of residual interests subject to a "dollar-for-dollar" deduction for risk-based capital purposes, and a concentration limit for leverage capital purposes, would be the "at-risk" amount; that is, the residual interests reduced by any associated deferred tax liability. For example, assume residual interests of \$100 with an associated deferred tax liability of \$35. Under this approach, the amount of residual interests subject to a "dollar-for-dollar" capital charge and a concentration limit is \$65 (\$100-\$35). In a worst-case scenario, if the value of the residual interests drops to zero, then the corresponding deferred tax liability would also drop to zero, and therefore capital would decline by \$65 - the net-of-tax amount. If the leverage capital limitation is \$50, then the deduction would be \$15 (\$65 - \$50). Under the second approach, the amount of residual interests subject to the "dollar-for-dollar" capital requirement and 25% of Tier 1 capital concentration limit would be determined on a gross basis, that is, without netting the associated deferred tax liability.

While this proposal should help remedy some of the major concerns associated with the generally illiquid and volatile nature of residual intrerests, the Agencies are also proposing to add language to the risk-based capital standards that will provide greater flexibility in administering the standards. Institutions are developing novel transactions that do not fit well into the risk-weight categories set forth in the standards. Institutions are also devising novel instruments that nominally fit into a particular risk-weight category, but that impose risks on the banking organization at levels that are not commensurate with the nominal risk-weight for the asset, exposure, or instrument. Accordingly, the Agencies are proposing to add language to the standards to clarify the Agencies' authority, on a case-by-case basis, to determine the appropriate risk-weight asset amount in these circumstances. Exercise of this authority by the Agencies may result in a higher or lower risk weight for an asset. This reservation of authority explicitly recognizes the Agencies' retention of sufficient discretion to ensure that institutions, as they develop novel financial assets, will be treated appropriately under the risk-based capital standards.

D. Relationship of this Residual Interest Proposal to the March 2000

Securitization Proposal

This proposed rule regarding residual interests (residual interest proposal) and the March 2000 notice of proposed rulemaking on the risk-based capital treatment of recourse arrangements, direct credit substitutes, and asset securitizations (the securitization proposal) are interrelated in that both proposals would address the

regulatory capital treatment for residual interests that are retained in connection with securitizations and other transfers of financial assets.²⁰ The capital treatment of residual interests under the securitization proposal differs in certain respects from the treatment proposed in this residual interest proposal. In any final rule that addresses the regulatory capital treatment of residual interests, the Agencies will ensure that any regulatory capital treatment of residual interests resulting from these two proposals will be consistent.

In the securitization proposal, the Agencies propose using external credit ratings to match the risk-based capital requirement more closely to the relative risk of loss in asset securitizations. Highly rated investment-grade positions in securitizations would receive a favorable (less than 100 percent) risk-weight. Below investment-grade or (unrated positions) in securitizations would receive a less favorable risk-weight (greater than 100 percent risk-weight or gross-up treatment). A residual interest retained by an institution in an asset securitization (as well as residual interests that are purchased) would be subject to this capital framework under the securitization proposal.

The residual interest proposal differs from the securitization proposal in several respects. For example, under the residual proposal, all residual interests that are retained by the institution and that fall within the 25 percent of Tier 1 capital limit would be subject to "dollar-for-dollar" capital treatment regardless of rating (and comment is sought on whether purchased interests should be treated similarly). To date, the Agencies believe that residual interests in asset securitizations generally are unrated and illiquid

²⁰ See 65 FR 12320 (March 8, 2000) for the text of the proposed revisions to the risk-based capital treatment of recourse arrangements, direct credit substitutes, and asset securitizations.

interests; however, as the market evolves, residual interests may in the future take the form of a rated, liquid, certified securities. If the rating provided to such a residual interest were investment grade (or no more than one category below investment grade) the securitization proposal would afford that residual interest more favorable capital treatment than the dollar-for-dollar capital requirement set forth in this residual interest proposal. In addition, the risk-based capital requirement for unrated residual interests that are subject to gross-up treatment under the securitization proposal would not exceed the full equivalent risk-based capital charge for the underlying assets that are being supported by the residual interest. Under this residual interest proposal, however, "dollar-for-dollar" capital would be required for the amount of the residual interest that is retained and falls within the 25 percent of Tier 1 capital limit, even if this amount exceeds the full capital charge typically held against the underlying assets that have been transferred with recourse. Also, unlike the residual interest proposal, the securitization proposal does not establish any concentration limit for residual interests as a percentage of capital.

These differences between the residual interest proposal and the securitization proposal will be taken into account in any final rule published under either proposal. In developing a final rule on residual interests, the Agencies specifically invite comment on how the capital treatment for residual interests under this residual interest proposal should be reconciled with the capital treatment set forth in the securitization proposal.

E. Effective Date

The Agencies intend to apply this rule to existing as well as future transactions. Because banking organizations may need additional time to adapt to any new capital treatment, the Agencies may delay the effective date for a specific period of time (transition period). The Agencies view this transition period as an opportunity for institutions to consider the rule's impact on their balance sheet structure and capital position. The Agencies invite comment on the need for and duration of a transition period.

VI. Request for Public Comment

The Agencies invite public comment on all aspects of the proposed rule. In particular, the Agencies request comment on the definition of residual interest, the treatment of residual interests in determining compliance with minimum capital requirements, the conditions established in the proposal, and the implementation of the proposal. The Agencies also specifically request comment on the "dollar-for-dollar" risk-based capital charge for residual interests, the 25 percent of Tier 1 capital concentration limit on the amount of residual interests that can be recognized for leverage and risk-based capital purposes, and the issue of whether a “net-of-associated deferred tax liability” approach is appropriate in determining the capital requirements for residual interests.

VII. Plain Language

Section 722 of the GLB Act (12 U.S.C.A. § 4809) requires federal banking agencies to use “plain language” in all proposed and final rules published after January 1, 2000. We invite your comments on how to make this proposed rule easier to understand.

For example:

- (1) Have we organized the material to suit your needs?
- (2) Are the requirements in the rule clearly stated?
- (3) Does the rule contain technical language or jargon that isn’t clear?
- (4) Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand?
- (5) Would more (but shorter) sections be better?
- (6) What else could we do to make the rule easier to understand?

VIII. Regulatory Analysis

A. Regulatory Flexibility Act Analysis

Board: Pursuant to section 605(b) of the Regulatory Flexibility Act, the Board has determined that this proposal will not have a significant impact on a substantial number of small business entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. 601 et. seq.). The Board’s comparison of the applicability section of this proposal with Call Report data on all existing banks shows that application of the proposal to small entities will be rare. Accordingly, a regulatory flexibility analysis is not required. In addition, because the risk-based capital standards generally do not apply to bank holding

companies with consolidated assets of less than \$150 million, this proposal will not affect such companies.”

FDIC: Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.) the FDIC hereby certifies that the final rule will not have a significant economic impact on a substantial number of small entities. Comparison of Call Report data on FDIC-supervised banks to the items covered by the proposal that result in increased capital requirements shows that application of the proposal to small entities will be the infrequent exception.

OTS: Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.) the OTS certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. Comparison of TFR data on OTS supervised savings associations regarding the items that would result in increased capital requirements indicate that the application of the proposal to small entities will be the infrequent exception.

OCC. [To be filled in by OCC]

B. Paperwork Reduction Act

The Agencies have determined that this proposal does not involve a collection of information pursuant to the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 et seq.).

C. OCC and OTS Executive Order 12866 Statement

The Comptroller of the Currency and the Director of the OTS have determined that the proposal described in this notice is not a significant regulatory action under Executive Order 12866. Accordingly, a regulatory impact analysis is not required.

D. OCC and OTS Unfunded Mandates Act Statement

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4, (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of \$100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. [The OCC and] OTS [has/have] determined that this proposed rule will not result in expenditures by state, local, and tribal government, or by the private sector, of more than \$100 million or more in any one year. Based on [the Call Report,] TFR and other data, OTS [and OCC] [estimates/estimate] that those [banks and] savings associations that

would be required to increase capital under the proposed rule will not incur additional expenses in this amount in any one year. Therefore, the OCC and OTS have not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

E. The Treasury and General Government Appropriations Act, 1999--

Assessment of Federal Regulations and Policies on Families

The Agencies have determined that this proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and Government Appropriations Act, 1999, Pub. L. No. 105-277, 112 Stat. 2681 (1998).

List of Subjects

12 CFR Part 3

Administrative practice and procedure, Capital, National banks, Reporting and recordkeeping requirements, Risk.

12 CFR Part 6

National banks, Prompt corrective action.

12 CFR Part 208

Accounting, Agriculture, Banks, banking, Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

12 CFR Part 325

Administrative practice and procedure, Banks, banking, capital adequacy, Reporting and recordkeeping requirements, Savings associations, State non-member banks.

12 CFR Part 565

Administrative practice and procedures, Capital, Savings associations.

12 CFR Part 567

Capital, Reporting and recordkeeping requirements, Savings associations.

**Office of Thrift Supervision
12 CFR Chapter V**

Authority and Issuance

For the reasons set out in the preamble, OTS proposes to amend parts 565 and 567 of chapter V of title 12 of the Code of Federal Regulations as follows:

PART 565 – PROMPT CORRECTIVE ACTION

1. The authority citation for part 565 continues to read as follows:

Authority: 12 U.S.C. 1831o.

2. Section 565.2 is amended by revising paragraph (f) to read as follows:

§ 565.2 Definitions

* * * * *

(f) *Tangible equity* means the amount of a savings association's core capital as computed in part 567 of this chapter plus the amount of its outstanding cumulative perpetual preferred stock (including related surplus) and disallowed residual interests minus intangible assets as defined in § 567.1 of this chapter and nonmortgage servicing assets that have not been previously deducted in calculating core capital.

* * * * *

PART 567--CAPITAL

3. The authority citation for part 567 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1828(note).

4. Section 567.1 is amended by adding definitions of financial assets, residual interests, and securitization to read as follows:

§ 567.1 Definitions

* * * *

Financial Asset. Financial asset means cash, evidence of an ownership interest in an entity, or a contract that conveys to a second entity a contractual right (1) to receive cash or another financial instrument from a first entity; or (2) to exchange other financial instruments on potentially favorable terms with the first entity.

* * * *

Residual Interests. (1) Residual interests means balance sheet assets that:

(i) Represent interests (including beneficial interests) in transferred financial assets retained by a seller (or transferor) after a securitization or other transfer of financial assets; and

(ii) Are structured to absorb more than a pro-rata share of credit loss related to the transferred assets through subordination provisions or other credit enhancement techniques.

(2) Residual interests do not include interests purchased from a third party.

(3) Residual interests include interest only strips receivable, spread accounts, cash collateral accounts, retained subordinated interests, and similar on-balance sheet assets that function as a credit enhancement.

* * * *

Securitization. Securitization means the pooling and repackaging of loans or other credit exposures into securities that can be sold to investors.

* * * *

5. Section 567.5 is amended by adding (a)(2)(iii) to read as follows:

§ 567.5 Components of Capital.

(a) * * *

(2) * * *

(iii) Residual interests that are not includable in core capital under 567.12 of this part are deducted from assets and capital in computing core capital.

* * * * *

6. Section 567.6 is amended by revising paragraph (a) introductory text, paragraph (a)(1) introductory text, and paragraph (b) to read as follows:

§ 567.6 Risk-based capital credit risk-weight categories.

(a) Risk-weighted assets. Risk-weighted assets equal risk-weighted on-balance-sheet assets (as computed under paragraph (a)(1) of this section), plus risk-weighted off-balance-sheet activities (as computed under paragraph (a)(2) of this section). Assets not included for purposes of calculating capital under § 567.5 are not included in calculating risk-weighted assets.

(1) On-balance-sheet assets. Risk-weighted on-balance-sheet assets are computed by multiplying the on-balance-sheet asset amounts times the appropriate risk weight categories, except for residual interests, which are discussed in paragraph (b) of this section. The risk weight categories for on-balance-sheet assets are:

* * * * *

(b) *Residual Interests*.

(1) *In general.* A savings association must maintain risk-based capital for a residual interest equal to the amount of the residual interest that is retained on the balance sheet (less any amount disallowed in accordance with section 567.12(e) and net of any associated deferred tax liability), even if the amount of risk-based capital required to be maintained exceeds the full risk-based capital requirement for the assets transferred.

(2) *Recourse Obligation.* Where a savings association holds a residual interest and another recourse obligation (such as a standby letter of credit), in connection with the same asset transfer, the savings association must maintain risk-based capital equal to the greater of: (i) the risk-based capital requirement for the residual interest as calculated under paragraph b(1); or (ii) the full risk-based capital requirement for the assets transferred, subject to the low-level recourse rules at paragraph (a)(2)(i)(C) of this section.

7. Section 567.9 is amended by revising paragraph (c)(1) to read as follows:

§ 567.9 Tangible capital requirement.

* * * * *

(c) * * *

(1) Intangible assets as defined in § 567.1 of this part, and servicing assets and residual interests not includable in tangible capital under § 567.12 of this part.

* * * * *

8. Section 567.11 is amended by redesignating paragraph (c) as paragraph (c)(1) and adding a new paragraph (c)(2) to read as follows:

§ 567.11 Reservations of authority.

* * * * *

(c) * * *

(2) If a savings association has calculated the risk-weighted asset amount under § 567.6, OTS may determine that risk-weighted asset amount does not adequately reflect the credit risk that the savings association retained in the transaction and require the institution to revise the risk-weighted asset amount to reflect the risk of, and other relevant factors associated with, the residual interest.

9. Section 567.12 is amended by revising the section heading and paragraphs (a), (b), and (e) and by deleting and reserving paragraph (f) to read as follows:

§ 567.12 Intangible assets, servicing assets, and residual interests.

(a) Scope. This section prescribes the maximum amount of intangible assets, servicing assets, and residual interests that savings associations may include in calculating tangible and core capital.

(b) Computation of core and tangible capital.

(1) Intangible assets, as defined in § 567.1 of this part (other than purchased credit card relationships described under paragraph (b)(2) of this section and core deposit intangibles described at paragraph (g)(3) of this section), are deducted in computing tangible and core capital.

(2) Purchase card relationships may be included (that is not deducted) in computing core capital subject to the restrictions of this section, but must be deducted in

computing tangible capital.

(3) Mortgage servicing assets may be included (that is not deducted) in computing core capital subject to the restrictions in this section, and may be included in tangible capital in the same amount.

(4) Nonmortgage servicing assets may be included (that is not deducted) in computing core capital subject to the restrictions in this section. All nonmortgage servicing assets must be deducted in computing tangible capital.

(5) Residual interests may be included (that is not deducted) in computing core capital subject to the restrictions of this section, and may be included in tangible capital in the same amount.

* * * * *

(e) Core capital limitation-(1) Aggregate limit. The maximum aggregate amount of servicing assets, purchased credit card relationships, and residual interests that may be included in core capital shall be limited to the lesser of:

(i) 100 percent of the amount of core capital computed before the deduction of any disallowed servicing assets, disallowed purchased credit card relationships, and disallowed residual interests; or

(ii) The amount of servicing assets and purchased credit card relationships determined in accordance with paragraph (d) of this section plus the amount of residual interests.

(2) Reduction by deferred tax liability. Associations may elect to deduct disallowed servicing assets and residual interests on a basis that is net of any associated deferred tax liability.

(3) Sublimit for purchased credit card relationships, non mortgage-related servicing assets, and residual interests. In addition to the aggregate limitation in paragraph (e)(1) of this section, a sublimit shall apply to purchased credit card relationships, non mortgage-related servicing assets, and residual interests. The maximum allowable amount of these three types of assets combined shall be limited to the lesser of:

(i) 25 percent of the amount of core capital computed before the deduction of any disallowed servicing assets, purchased credit card relationships, and residual interests; or

(ii) The amount of purchased credit card relationships and non mortgage-related servicing assets determined in accordance with paragraph (d) of this section plus the amount of residual interests.

(f) Reserved.

* * * * *

DRAFT

Dated: _____, 2000.

By the Office of Thrift Supervision

Ellen Seidman

Director